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SUMMARY RECORD OF THE 450th MEETING

Held at the Vienna International Centre, Vienna,
on Monday, 17 June 1991, at 2 p.m.

Chairman: Mr. SONO (Japan)

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The meeting was called to order at 2.10 p.m.

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS
(continued) (A/CN.9/341, 344 and Corr.1, 346 and 347 and Add.1)

Article 5 (continued)

1. The CHAIRMAN invited the Commission to consider article 5(a) and article 5(b)(i) to (ii).

2. Mr. CRAWFORD (Canada) said that, as the observer for Finland had indicated at the previous meeting (A/CN.9/SR.449, para. 64), there did appear to be a conflict between article 5(b)(ii) and article 17(2). Article 5 had not been in the draft Model Law for long and an understanding of its intent and scope was still developing. His interpretation of the words "another bank" in article 5(b)(ii) was that they referred to a bank with which the receiving bank did not have an existing banking relationship. Article 5(b)(iii), it would be noted, referred to the central bank of the State where the receiving bank was located and in that case the rule operated simply: the receiving bank was paid when it received settlement at its country's central bank. That was unquestionable. In the case contemplated in article 5(b)(ii), however, if the words "another bank" referred to a situation in which the receiving bank was offered as settlement a credit at a bank with which it had no account or central bank relationship, naturally it would be careful about accepting the credit. Accordingly, in that case the rule had to be carefully expressed along the following lines: if the receiving bank was offered settlement on the books of a bank which was not its settlement bank or a bank with which it had an established relationship, then the settlement would be regarded as payment only when the receiving bank used it.

3. If a banker-and-customer relationship had already been established by the receiving bank with the other bank, the case would probably be covered by article 17(2), so that the insolvency example given by the Government of Finland in its written comments (A/CN.9/347, p. 19) might be decided under that provision. To cover the case where such a relationship had not been established, it was better to have the rule in article 5(b)(ii), with the risk of occasional unacceptable consequences, than to have no rule at all.

4. Mr. BHALA (United States of America) said that the solution envisaged by the Canadian representative to the possible conflict between article 5(b)(ii) and article 17(2) would work well. There were now two ways of dealing with the matter. He did not believe it necessary to talk in terms of the deletion of article 17(2); the Commission was at present talking about a relatively limited problem and must be careful not to perform radical surgery on the Model Law. The idea to preface the introductory wording to article 5 with the words "for the purpose of this Model Law" was acceptable and would cater for the insolvency situation.

5. Mr. DE BOER (Netherlands) thought that if the Canadian suggestion was that article 5(b)(ii) should include the words "another bank with which there is no established relationship", difficulties would arise in determining with

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certainly whether there was an established relationship or not. It would be unwise not to limit the scope of article 5. The Model Law could not be considered in isolation from insolvency law; the latter did not generally refer to the time of a payment, but either to the general law of obligations or to a specific law of obligations such as the Model Law. It would not be enough to include the words "for the purpose of this Model Law" in the introductory wording to article 5 in order to exclude the operation of insolvency law: that intention must be made explicit.

6. Mr. ERIKSSON (Observer for Sweden) said that the provisions of article 5 were clearly needed in relation to articles 6 and 8, but they caused some problems in relation to articles 13 and 17. Nothing that had been said in the discussion of article 5 had convinced him that the provisions of article 5 were needed for any reasons other than those related to articles 6 and 8.

7. At the previous meeting (A/CN.9/SR.449, para. 57), the United States representative had indicated that the Commission should look ahead to broader possible applications of the Model Law. He could not agree with that approach. The Commission must take care not to introduce into the Model Law rules that might have consequences that could not be foreseen at the moment. It should confine itself to applying the provisions of article 5 in relation to articles 6 and 8.

8. Mr. BHALA (United States of America) said that the Commission had not considered the effect of excluding the operation of article 5 in respect of all situations except deemed acceptance. Moreover, his delegation was not seeking to prejudice the application of local insolvency law.

9. Mr. ABASCAL ZAMORA (Mexico) said that he had difficulty in understanding the connection of article 5 with article 17(2) since in his view they related to different matters: article 5 referred to the stage when a sender fulfilled the obligation to pay and article 17(2) to the stage when a transfer was completed and the obligation of the originator was discharged.

10. The CHAIRMAN called for comments on article 5(b)(iii).

11. Mr. LE GUEN (France) said that in his delegation's view article 5(b)(iii) as it stood was too restrictive in using the words "when final settlement is made in favour of the receiving bank at the central bank of the State where the receiving bank is located". From 1993 onwards any bank in a country in the European Economic Community would be able to carry out any banking operations in any other EEC State, even if it did not have a physical presence in that other State. The Community's central banks might therefore have to open accounts with, and include in their payments systems, commercial banks which were not physically located in their own State.

12. His delegation therefore wished article 5(b)(iii) to be drafted in broader terms along the following lines: "when final settlement is made in favour of the receiving bank by a central bank with which the receiving bank has an account". Without such an amendment, if the receiving bank was located

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in the same State as the central bank settlement by the central bank would be immediate, whereas if it was located in a different State settlement would take place under article 5(b)(ii), i.e. on the following business day. He saw no reason why there should be a one-day difference in the time of comparable settlements by central banks merely because of their geographical location.

13. Mr. HARRIS-BURLAND (Commission of the European Communities) supported the French proposal. The suggested wording would apply to two situations not at present covered by article 5(b)(iii). The first was when the receiving bank had a branch in a State and that was the branch involved in the credit transfer; it might be that the head office of the receiving bank was in a different State. The branch might have an account with the central bank in its own country, but under article 5(b)(iii) as it stood that would not count, since the central bank making the settlement had to be that of the country of the receiving bank itself and not that of the country of its branch. Extending the scope of article 5(b)(iii) as suggested would take account of the situation in which a branch of the receiving bank had an account with the central bank in the State where the branch was located. That was not to imply that central banks had to open accounts with such branches nor that branches should seek to have such accounts, but if they did, article 5(b)(iii) should be worded so as to cover the situation.

14. The other situation he had in mind was when the receiving bank did not have a presence in the territory of the central bank in which settlement was made but maintained an account relationship with it. In such cases there should be no objection to final settlement being possible under article 5(b)(iii).

15. The CHAIRMAN asked the Commission whether it considered that a branch or a separate office of a bank should be treated as a separate bank for the purpose of article 5.

16. Mr. CRAWFORD (Canada) said that he had had instructions to agree to that suggestion but nevertheless thought it a novel arrangement for branches of a single bank located in the same State to have separate accounts at its central bank.

17. Mr. SCHNEIDER (Germany) pointed out that a distinction must be made between the provision of cross-border services by banks and their having branches in other countries. It would not be enough merely to add that branches were regarded as separate banks for the purpose of article 5. The EEC Second Banking Directive allowed the provision of cross-border financial services without the establishment of branches. He therefore supported the French proposal.

18. Mr. GREGORY (United Kingdom) said that, for the purpose of article 5, branches of the same bank should be treated as separate banks. That made sense, since in other provisions of the Model Law which related to time there was generally a rule that branches of banks should be considered as separate

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banks. His delegation approved the French proposal and did not think it was incompatible with providing that branches should be treated as separate banks.

19. Mr. BURMAN (United States of America) said that his delegation also supported the French proposal.

20. Mr. EFFROS (International Monetary Fund) said that the Commission should consider article 5(b)(iii) not only within the context of the European Economic Community but also in regard to central banks located elsewhere. If a receiving bank had an account with a central bank and that account was blocked by exchange controls, as could happen in some countries outside the Community, a credit to that account which was not freely available should not be regarded as a final settlement. The Commission should therefore consider amending article 5(b)(iii) in the manner proposed by France but with the words "that is freely available for use", or wording to that effect, added at the end.

21. Mr. LE GUEN (France) said that the changes suggested by the International Monetary Fund would not affect the European Economic Community but would have serious consequences for central banks. Some countries had mandatory reserves, in other words, deposits which commercial banks must maintain at central banks. He understood the point about exchange controls but believed that, if it accepted the change in question, the Commission might well create confusion about the time when payment was made by a central bank in a situation in which the amount of the payment equalled the amount of the monetary resources which the receiving bank had to maintain at the central bank. Consequently, he opposed the text suggested by the International Monetary Fund.

22. Mr. HARRIS-BURLAND (Commission of the European Communities) said that the point made by the International Monetary Fund was also relevant to article 5(b)(ii) in connection with a credit entered to an account of the receiving bank in another bank. He supported the French representative's view that the Commission should not accept the text suggested by the Fund.

23. The CHAIRMAN said that if he heard no objection, he would take it that the Commission adopted the French proposal for article 5(b)(iii).

24. It was so decided.

25. The CHAIRMAN invited the Commission to consider subparagraph (b)(iv) of article 5.

26. Mr. PELICHET (Hague Conference on Private International Law) said that in its written comments (A/CN.9/347, p. 71), the Conference had proposed the deletion of the words "applicable law and". He recalled that during its discussion of the provision, the Working Group had expressed doubts about the reference to applicable law. It was not possible to speak of interbank netting arrangements and applicable law in the same provision since there was no particular national law to which multilateral netting settlements could be subject.

27. Mr. CRAWFORD (Canada) said that his delegation supported the proposal. He thought it unnecessary for the Commission to investigate the manner in which national legal systems might regulate interbank netting schemes. For the purposes of the Model Law, it might be assumed that any bilateral or multilateral netting scheme to which banks in countries adopting the Model Law were a party would have a satisfactory foundation in the legal system of the country concerned.

28. Mr. LE GUEN (France) said that his delegation also supported the proposal. It did not think that all netting systems were capable of offering guarantees of efficiency. The work done by the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries showed clearly the need for caution in that regard. The Committee had recommended a list of minimum criteria to be met by netting systems in order for them to be regarded as valid by central banks. That suggested the possible existence of netting systems which did not meet those criteria.

29. Mr. FUJISHITA (Japan) said that his delegation thought that the entire provision should be deleted. However, if the majority of the Commission wished to retain it, Japan would agree to that and to the proposal made by the Permanent Bureau of the Hague Conference.

30. Mr. NEWMAN (United States of America) said that his delegation also supported the Hague Conference proposal.

31. With regard to the French representative's comments about unsatisfactory netting schemes, he did not believe that a new netting scheme would be approved by a central bank unless it met the guidelines set out in the document prepared on the subject by the International Monetary Fund.

32. Mr. VASSEUR (Banking Federation of the European Community) said that his delegation also supported the proposal. It welcomed the fact that the Model Law referred to bilateral and multilateral netting systems. It hoped that the Commission's report would contain the recommendation made by the Working Group on International Payments (A/CN.9/344, p. 14, para. 61) that national legislators should review domestic laws, especially laws dealing with bankruptcy and insolvency, with the objective of supporting interbank netting of payment obligations.

33. Mr. LE GUEN (France) said that he did not share the United States representative's view that a central bank would not approve an inefficient netting system. There was no legal obligation, at least under French law, for netting systems to meet the minimal criteria set out in the report of the Group of 10. A netting system was essentially a contract between participating banks and they therefore had the right to organize themselves as they wished. The report of the Group of 10 said that central banks should have the right to supervise netting systems and in some cases the right to say that such systems did not meet the minimum criteria, but it did not actually recommend a control mechanism. His delegation did not want a substandard netting system to be treated under article 5(b)(iv) as if it were making valid payments. He therefore proposed the addition at the end of article 5(b)(iv), to govern the

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entirety of sub-subparagraph (iv), of the words "provided the rules governing the system are compatible with this law", or wording to that effect.

34. Mr. CRAWFORD (Canada) said that, while he understood the desire of the French delegation that aberrant netting systems should not be recognized, it would be wrong for the provision to be worded in such a way that it afforded the possibility of a broad inquiry as to whether the rules of a given system were compatible with the Model Law. All central banks were well aware of the recommendations of the Group of 10 and multilateral settlement schemes were under the supervision of central banks everywhere. An alternative to the French proposal might be to provide that bilateral and multilateral netting schemes were to be considered acceptable provided that they were acceptable to the central banks of the places where they operated.

35. Mr. NEWMAN (United States of America) agreed with the representative of Canada as far as multilateral funds transfer systems were concerned. The question of bilateral netting schemes was quite a different matter; in that case, two banks exchanging messages and settling net were of no concern to central banks.

36. Mr. CRAWFORD (Canada) replied that in countries where the capital adequacy rules of the Bank for International Settlements were being enforced vigorously, central bank supervisors were very interested in bilateral netting arrangements because banks relied on them to depress their net claims against other banks to their net amount.

37. The CHAIRMAN observed that the supervisory authorities envisaged in the suggestion by the representative of Canada might not exist in all States. If the wording suggested by France was altered to read "the law" instead of "this law", the point would be covered.

38. Mr. LE GUEN (France) said that his delegation believed that, although some netting systems were very new, netting systems should be mentioned in the Model Law in order to accord them some sort of recognition. With such a complicated matter, however, it was necessary to proceed very cautiously. The Chairman's suggestion to change the words "this law" to read "the law" was open to the objection that for multilateral netting systems to be effective they must be legally valid, possibly under several different legal systems; the words "the law" could give rise to the operation of a whole range of laws, a situation which would be conducive to uncertainty.

39. Mr. GREGORY (United Kingdom) endorsed the views expressed by the representatives of Canada and the United States. His delegation's preference was for leaving the text as it stood but with the deletion of the words "applicable law and". The question of the validity of bilateral or multilateral netting systems could safely be left to be determined by whatever rules were valid under the system applicable to them in the different countries concerned; in many countries they would be subject to supervision on an individual basis by central banks or some other body.

40. Mr. TCHERNYCHEV (Union of Soviet Socialist Republics) agreed.
41. The CHAIRMAN said that, unless he heard any objection, he would take it that the Commission approved the text of article 5(b)(iv) with the deletion of the words "applicable law and".
42. It was so agreed.
43. The CHAIRMAN reminded the Commission that it should take a decision on the recommendation by the Working Group to which the observer for the Banking Federation of the European Community had referred. He suggested that the Commission should state in its report that, in adopting article 5(b), it had taken note of the Working Group's recommendation.
44. It was so agreed.
45. The CHAIRMAN invited the Commission to consider article 5(c).
46. Mr. BERGSTEN (Secretary of the Commission) said that the observer for The Hague Conference on Private International Law had informed him that the suggestion made by the Permanent Bureau of the Conference to delete article 5(c) (A/CN.9/344, p. 32) might be taken care of instead through drafting the provision in such a way as to make it clear that it referred to rules of law generally. The observer for The Hague Conference had made an alternative suggestion with regard to subparagraph (c), namely to restructure article 5 by inserting, in the introductory wording to the article, words to the effect that payment should take place in accordance with subparagraph (a) or subparagraph (b), thereby obviating the need for subparagraph (c) altogether.
47. The CHAIRMAN said that was an interesting suggestion but it went beyond the scope of the present discussion. His own suggestion was that a form of words such as "for the purposes of this Model Law" should be introduced in such a way as to apply not only to article 5 but to articles 6 and 8 as well. The Commission might wish to reflect on the implications of that suggestion and in the meantime take up article 6.

Article 6

48. Mr. CRAWFORD (Canada) said that the concept of deemed acceptance had been incorporated in the draft in an attempt to guard against the vice of inertia which affected the operation of the international banking system. In his view, that left the problem solved in an unacceptable manner. It might be better to punish the vice of inactivity instead of deeming it to be something which it was not.
49. On very practical grounds, senders of payment orders might feel that the Model Law gave them less than they deserved if, through the operation of its deemed acceptance rule, they found that they had an unwilling representative in a bank abroad. A receiving bank which was bound to implement a payment order only by virtue of having missed the deadline for rejecting it was a poor representative of the sender and an unwilling participant in the credit

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transfer. In his view, that kind of delay in executing a payment order should be penalized in a way which affected the receiving bank only, and not, as would be the case under the existing penalty provisions in the Model Law, the sender as well. He therefore recommended providing for an interest penalty based on the length of delay.

50. Mr. BHALA (United States of America) said that the representative of Canada had summarized the problem perfectly and had shown why the remedies at present available in regard to article 6(2)(a) and article 8 were unsatisfactory. He felt that the Canadian proposal was a satisfactory basis on which to advance. It was a good idea to treat inactivity as a delay problem, an area in which the Model Law worked well, rather than penalize the sender by attaching him to a receiving bank that was pursuing his interests in a dilatory manner. He thought that interest on the amount of the payment order that had been delayed might be a fitting penalty.

51. Mr. NEWMAN (United States of America), speaking from an operational perspective, said that very few banks processed payment orders on a real-time on-line basis; most still used the batch mode. That meant that, for several reasons, it was not until the following morning that they knew whether they had funds available to execute payment orders or whether there were problems entitling them to reject a payment order on the execution date. It would therefore be unrealistic for the Model Law to contain a rule to the effect that a payment order was deemed accepted if the transaction had not been processed by the bank and the bank had had no opportunity to reject it.

52. Mr. GREGORY (United Kingdom) said that the Canadian proposal merited consideration. It was his understanding, however, that the rules regarding deemed acceptance entailed that a payment order must either be accepted or rejected: a bank receiving a payment order was under an obligation to take action, as distinct from an obligation to pay compensation. His delegation had proposed in its written comments (A/CN.9/347, p. 57) the addition to article 6 of a paragraph 2 his providing for an extra day for rejection of a payment order.

53. Ms. KOSKELO (Observer for Finland) said that in her view the only penalty arising from late execution following deemed acceptance would be payment of compensation for interest. In the light of the considerations put forward by the United States delegation there might be some advantage in clarifying the circumstances in which deemed acceptance could be claimed to have occurred and in which consequential damages might be payable due to failure by the receiving bank to take action. The proper context for such a discussion would be paragraph 8 of article 16. It should be borne in mind that the concept of deemed acceptance was very useful in ensuring that banks fulfilled their obligations, but banks must also be afforded the possibility of rejecting a payment order.

54. Mr. BHALA (United States of America) said that the Canadian proposal was a significant contribution to the discussion. The point to be emphasized was that a receiving bank had a duty to give notice of rejection, as was affirmed by the existing text of article 6(3).

55. Mr. NEWMAN (United States of America) said that article 6(3) should make provision for an additional day for rejection, thus taking account of the point made by the representative of the United Kingdom.

56. Mr. GREGORY (United Kingdom) said that in some, but not all, cases an extra day allowed for rejection would be excessive. Problems arose only in the case of deemed acceptance: other methods of acceptance all required the receiving bank to take specific action for which it should not need any additional time for reflection. His delegation's suggestion was merely to take into account those cases in which the extra day was in fact needed for rejection.

57. Mr. POTYKA (Observer for Austria) said that, in practice, a bank could not be deemed to have accepted a payment order if it had not had time to process the order, and that should be the criterion in establishing time-limits. His delegation supported the suggestion made by the United States, in the interests of avoiding unnecessary complexity in the Model Law.

58. Mr. ABASCAL ZAMORA (Mexico) said that the Canadian proposal should be explored in greater depth, particularly in view of the considerations raised by article 8 and the need to ensure restitution in the event of negligence on the part of a bank which failed to execute a payment order without stating that it had rejected it. He did not think that the issue was the same as that raised by article 16. If there was to be a notion of deemed acceptance, there should equally be a notion of deemed rejection.

59. Mr. SCHNEIDER (Germany) said that the rule applicable in the countries of the European Economic Community was for a two-day time-limit, which would adequately meet the concerns of both the United States and the Austrian delegations. However, a solution might be found in the context of article 10.

60. The CHAIRMAN said that the deemed acceptance approach seemed, despite some divergences of view, to enjoy broad support, but that adjustments would have to be made to take account of concerns relating to time-limits.

The meeting rose at 5.05 p.m.